No. 15,310

IN THE

United States Court of Appeals

For the Ninth Circuit

SUNLAND INDUSTRIES, INC., a Corporation,	*Appellant,*
vs.	
UNITED STATES OF AMERICA,	*Appellee.*

BRIEF FOR APPELLANT.

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Table of Contents

Table of Authorities Cited

Cases

Statutes

Other Authorities

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BRIEF FOR APPELLANT.

JURISDICTION.

This is an action for the refund of Federal excess profits taxes for 1943. The District Court had jurisdiction of this action under and pursuant to the provisions of Section 1346(a)(1) of Title 28 of the United States Code as it existed on May 1, 1952, the date upon which the Complaint was filed. The Section cited gives jurisdiction to the District Court of suits for the recovery of Federal taxes where all of the Collectors of Internal Revenue to whom the taxes were paid are no longer in office even though the amount involved may be in excess of $10,000. This is an action for the recovery of the sum of $78,130.71 paid

December 14, 1949, to the Collector of Internal Revenue at San Francisco, which said sum is alleged to have been erroneously and illegally assessed and collected. The facts establishing jurisdiction are set forth in Plaintiff's Complaint in the following paragraphs at the pages of the Transcript of Record* indicated in parentheses thereafter: Paragraphs 1 and 2 (page 3) paragraph 3 (page 4) paragraph 8 (page 5) paragraph 10 (pages 5 and 6).

On June 1, 1956, the Court below made an Order Denying Motion for a New Trial (R. 59) which made final the judgment theretofore entered on April 16, 1956 (R. 56), and this Court has jurisdiction under Section 1291 of Title 28 of the United States Code and under Section 1294(1) of Title 28 of the United States Code. These Sections give the United States Courts of Appeals jurisdiction over all final judgments of the District Courts and designate the Circuit to which the appeal shall be taken.

STATEMENT OF THE CASE.

Appellant brought this action to recover $78,130.71 paid December 14, 1949, on the grounds that such sum was erroneously and illegally assessed and collected in that it was assessed and paid "after the expiration of the period of limitation properly applicable thereto" under Section 3770 (a) (2) of the Internal Revenue Code of 1939, 26 USC 3770(a)(2) (re-

*Hereinafter abbreviated "R."

produced in full in appendix (p. iii)). The only question involved in this proceeding is whether all or any portion of the amount paid December 14, 1949, is governed by the special Statute of Limitations contained in Section 710(a)(5) of the Internal Revenue Code of 1939 (26 USC 710(a)(5)). If such period of limitations does not apply, then the payment made December 14, 1949, was made "after the expiration of the period of limitation properly applicable thereto", and is refundable to Appellant together with interest thereon from the date of payment. (26 USCA Section 3771).

Jurisdiction of the Court and compliance with the conditions precedent to maintaining an action for a refund are not in issue so this Court may confine its attention to the facts and the law directly concerned with the question of whether the $78,130.71 paid December 14, 1949, was governed in whole or in part by the provisions of Section 710(a)(5) of the Internal Revenue Code of 1939. Section 710(a)(5) of the Internal Revenue Code of 1939 is reproduced in full in the appendix (p. ii).

The portion of the World War II excess profits tax law which is relevant to this proceeding provided a pattern of "relief" for taxpayers who could demonstrate that their earning's history was "abnormal." The method of securing such relief in the usual relief case was by paying the tax in full and then filing an Application for Relief which constituted a claim for refund. Section 710(a)(5) provided an exception to the general rule allowing a deferment of pay-

ment of a part of the tax where the taxpayer met certain additional qualifications. A special Statute of Limitations to cover such amounts was enacted into such section in 1948.

The relevant facts are as follows: The Appellant filed its excess profits tax return for the calendar year 1943 on March 15, 1944, and disclosed an excess profits tax liability of $193,238.42. Of this amount, the taxpayer paid in installments $129,469.76 (Stipulation, paragraph II, R. 16, et seq.). The remaining amount of $63,768.68 was not paid until December 14, 1949 (R. 18), and both parties agree that the general Statute of Limitations (which would be applicable if the provisions of Section 710(a)(5) of the Internal Revenue Code of 1939 do not apply) had then expired.

The printed form of return contained an item designated line "17", which bore the following caption, "Amount deferred by reason of application of Section 710(a)(5) (relating to abnormality under Section 722 (attach schedule))" and on this line the Appellant made the following entry: "In accordance with claim on file, 1942", and the amount "$63,768.68" (R. 17). Although the Regulations required it, no application for relief was filed with the return, nor were there any schedules or statements filed with the return showing the computation of any excess profits tax relief, nor any computation of the amount deferred (Stipulation R. 18). There were no schedules or statements on the original excess profits tax return for 1943 nor on any material filed with the said excess profits tax return disclosing:

1. The computation in support of the amount entered on line 17 of the excess profits tax return;

2. Grounds for relief or facts in support of grounds for relief under Section 722;

3. A constructive average base period net income or facts in support of a constructive average base period net income (Stipulation R. 18).

Nor was there any disclosure of the percentage relationship between the adjusted excess profits net income (without consideration of Section 722) and the normal tax net income (without consideration of Section 26(e)) on the original excess profits tax return itself nor on any material attached to or filed with the return (Stipulation R. 19).

No claim for relief with respect to 1943 was filed until March 12, 1946 (Stipulation R. 18), although a claim for relief for 1942 had been filed on September 15, 1943 (Stipulation R. 18).

The amount of tax that was unpaid upon the filing of the returns was paid December 14, 1949, and was not assessed until January, 1950 (R. 68 and 69).

The question presented, therefore, is as follows:

Was the $78,130.71 paid December 14, 1949, "an amount of tax remaining unpaid pursuant to Section 710(a)(5)"?

SPECIFICATION OF ERRORS.

1. The Court erred in failing to hold that the $78,130.71 paid December 14, 1949, was paid after the expiration of the period of limitations properly applicable thereto. The Court erred in holding that the special Statute of Limitations contained in Section 710(a)(5) of the Internal Revenue Code of 1939 applied to the $78,130.71 paid December 14, 1949.

2. The Court erred in basing its decision on affirmative defenses of "waiver" and "estoppel" which had neither been pleaded nor proved. The Court erred in overruling Plaintiff's objection to the admission of the evidence contained in paragraph VII of the Stipulation (R. 26 et seq.). In accordance with the stipulation of the parties (R. 85) Plaintiff objected to the admission of all of the evidence contained in paragraph VII of the Stipulation on the grounds that "Said facts are immaterial and irrelevant to this proceeding in that said facts bear solely upon matters constituting an avoidance or an affirmative defense which has not been pleaded as required under F.R.C.P. 8(c)" (R. 41).

3. The Court erred in deciding the case before it was submitted (last paragraph, R. 97; Defendant's Brief filed March 7, 1956, R. 40; Plaintiff's Reply Brief containing objection filed March 27, 1956, R. 40 and 41; Minutes of the Court, March 23, 1956, R. 43; Order Overruling Plaintiff's Objection, R. 44).

SUMMARY OF ARGUMENT.

1. The Appellant failed to pay when due the sum of $63,768.68[1] excess profit taxes for the year 1943 and also failed to submit with its return any information to justify the deferment of this amount under Section 710(a)(5) of the Internal Revenue Code and the Regulations promulgated thereunder. In such circumstances the Regulations specifically provided that there should be no deferment, that such an amount constituted a part of the "amount of tax shown by the taxpayer on his return" under Section 271 and that the entire tax including such sum should be assessed and collected immediately. These Regulations, being *legislative,* had the force and effect of law, were binding on the taxpayer and Defendant alike, and the failure of the Defendant to follow these Regulations allowed the Statute of Limitations applicable to this sum to expire.

2. The Defendant neither pleaded nor proved any facts in avoidance of Plaintiff's cause of action and the Court erred in basing its decision on the defense of "waiver."

3. The Trial Court committed prejudicial error in deciding the case before it was submitted and prior to considering and acting upon Plaintiff's timely and valid objection to the admission of certain evidence.

4. This being a case where all of the facts have been stipulated the Appellate Court is free to con-

[1]This is the actual amount shown on the return. For convenience this brief often refers to the "$78,130.71" as the amount deferred, but such sum also included interest.

sider them and reach its own conclusions untrammeled by the District Court's findings of fact and conclusions of law.

ARGUMENT.

I.

THE $70,130.71 WAS NOT AN "AMOUNT REMAINING UNPAID PURSUANT TO" SECTION 710(a)(5) AND WAS A PART OF "THE AMOUNT OF TAX SHOWN BY THE TAXPAYER ON HIS RETURN" UNDER SECTION 271.

A. Section 710(a)(5) required Regulations to make it operative.

The full text of Section 710(a)(5) is as follows:

> "Sec. 710(a)(5).—Deferment of Payment in Case of Abnormality. If the adjusted excess profits net income (computed without reference to section 722) for the taxable year of a taxpayer which claims on its return, in accordance with regulations prescribed by the Commissioner with the approval of the Secretary, the benefits of section 722, is in excess of 50 per centum of its normal tax net income for such year, computed without the credit provided in section 26(e) (relating to adjusted excess profits net income), the amount of tax payable at the time prescribed for payment may be reduced by an amount equal to 33 per centum of the amount of the reduction in the tax so claimed. For the purposes of section 271, if the tax payable is the tax so reduced, the tax so reduced shall be considered the amount shown on the return. *Notwithstanding any other provision of law or rule of law, to the extent that any amount of tax remaining unpaid pursuant to this paragraph is in excess of the reduction in tax finally determined under section 722, such*

excess may be assessed at any time before the expiration of one year after such final determination." (Italicized portion added by Public Law 635, passed June 12, 1948).

Congress intended this section only as the skeleton of the power of deferment. That is all it contains. The muscle and sinew was to be added by the Commissioner of Internal Revenue as shown by the phrase "in accordance with regulations prescribed by the Commissioner with the approval of the Secretary."

Although Congress had previously granted to the Commissioner the right to make all needful rules and regulations concerning the entire subject matter of the revenue laws (IRC 62, 26 USC 62; and IRC 3791(a)(1), 26 USC 3791), Congress did not deem such a general authority sufficient for the purposes of this section and specially granted to the Commissioner the power and the duty to build upon the framework of the section a complete and cohesive system and procedure for the granting and denying of the deferment described therein.

Regulations were promulgated by the Commissioner under this section on March 18, 1943, and were expressly promulgated under the authority of this section. Treasury Decision 5246, 1943 Int. Rev. Cum. Bul. pages 648-672.

B. Regulations promulgated under circumstances such as these are "legislative" not "interpretative" and have the force and effect of law.

Where Regulations are promulgated under and pursuant to specific authority conferred in the section

itself and not solely under the general power granted in Section 3791(a)(1) or Section 62 of the Internal Revenue Code of 1939, such Regulations are legislative in character and have the force and effect of law.

This concept is most clearly expressed in *Davis on Administrative Law* by Kenneth Culp Davis, West Publishing Company, 1951, at page 196 as follows:

> "But many provisions of the tax regulations (one commentator counted 56 in the income tax law in 1940) are legislative rules, because they spring from grants of power to create new law. For instance, Section 23(m) provides for a 'reasonable allowance' for depletion 'under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary'."

The distinction between legislative and interpretative rules is also clearly expressed in the same text at page 194:

> "According to the theory, legislative rules are the product of a power to create new law, and interpretative rules are the product of interpretation of previously existing law. Legislative rules may change the law but interpretative rules merely clarify the law they interpret. Valid legislative rules have the same force and effect as valid statutes; the rules are valid if proper procedure is followed and if they are within the statutory and constitutional authority of the agency."

This doctrine is clearly recognized by *Helvering v. Wilshire Oil Co., Inc.,* 308 US 90, 60 S. Ct. 18 (1939); and *Douglas v. Commissioner,* 322 US 275, 64 S. Ct.

988 (1944) as well as by *Guanacevi Mining Co. v. Commissioner,* 127 F. (2d) 49 (9th Circuit 1942).

Each of the cases cited above had under consideration the provisions of Section 23(m) referred to in the quotation from *Davis on Administrative Law* set forth above which contained as its authorization for the legislative Regulations the phrase: "Under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary." The Regulations here involved were authorized by language differing only slightly: "In accordance with Regulations prescribed by the Commissioner with the approval of the Secretary."

These authorities establish that the Regulations discussed in the next subdivision are just as binding upon the Commissioner as they would be if their provisions were contained in Section 710(a)(5) itself.

A further discussion of the concept is contained in the following law review articles:

Administrative Rules, Interpretive Legislative by K. C. Davis, 57 Yale Law Journal, 919 (1948);

Treasury Regulations and the Wilshire Oil Case by E. C. Alvord, 40 Columbia Law Review 252, 258 (1940);

Treasury Regulations—Interpretive or Legistive? by J. W. Purdy, 23 Cincinnati Law Review, 332 (1954).

C. The Regulations specifically provide that the $70,130.71 is part of "The amount of tax shown by the taxpayer on his return."

The Regulations promulgated pursuant to the authority discussed above are set forth in full in the Appendix at page iv.

To provide a clear and complete comparison of what is required by the Regulations and what the Appellant did, there will be set forth below in parallel columns, the requirements in Regulations and what the Appellant actually did:

Requirements of Regulations.	**What Appellant Did.**
1. "A taxpayer which claims to be entitled to a tax deferment under the provisions of Section 710(a)(5) and of this Section *must,* at the time of filing its excess profits tax return on Form 1121, attach thereto an application for relief under Section 722 on Form 991 (revised January, 1943)." (Emphasis supplied.)	1. No application on Form 991 for relief under Section 722 of the 1939 Revenue Code was attached to or filed with the Plaintiff's excess profits tax return for 1943 (Stipulation paragraph II(E), R. 18, Findings IV R. 48).
2. "The application must set forth *under oath:*	2. There were no schedules or statements on the excess profits tax return for 1943 or any material filed with said excess profits tax return setting forth:
(a) Each ground under Section 722 upon which the application for relief is based;	(a) Grounds for relief;
(b) And facts sufficient to apprise the Commissioner of the exact basis thereof and to establish eligibility for relief;	(b) Facts in support of grounds for relief;

Requirements of Regulations.	What Appellant Did.
(c) As well as data and information in sufficient detail to establish the amount of constructive average base period net income claimed;	(c) A constructive average base period net income or facts in support of a constructive average base period net income;
(d) The amount of tax reduction claimed by the use of Section 722;	(d) The amount of tax reduction claimed by the use of Section 722;
(e) The amount of tax deferment claimed on the return."	(e) Computations in support of the amount entered on line 17, Form 1121 (See Stipulation paragraph II(H) R. 18 and 19).

Nor were there any schedules or statements on the excess profits tax return for 1943, nor any material filed with said excess profits tax return disclosing the per centum relationship between the excess profits net income and the normal tax net income required to establish eligibility for deferment under the statute itself (Stipulation II(I) R. 19).

Not only did the Regulations *legislatively* promulgated under this Section provide for the form and content required for deferment, but they also anticipated and provided for exactly what is involved in this case. The relevant portion of the Regulations is as follows:

> "In any case in which an application for relief on Form 991 (revised January, 1943) is not so attached to the excess profits tax return, the taxpayer shall not be deemed to have claimed on its return the benefits of Section 722. In such case, the amount of tax deferment claimed under Sec-

> tion 710(a)(5) and this section shall be added to the amount of tax otherwise shown by the taxpayer to be payable. For the purposes of Section 271 (made applicable to Subchapter (E) of Chapter 2 by Section 729) relating to the definition of deficiency, *the amount of tax shown by the taxpayer to be payable so increased shall be considered the amount of tax shown on the return.*" (Emphasis supplied).

It is clear that the requirement of the above quotation is the requirement that the Form 991 be filled out in accordance with the previous portions of the Regulations; and that the attaching of an obviously incomplete Form 991 would not satisfy the requirements of these Regulations any more than the filing of an obviously incomplete tax return would be sufficient in a closely analogous situation to start the running of the Statute of Limitations.

In *Lucas v. Pilliod Lumber Co.,* 281 US 245, 50 S. Ct. 297 (1930) the Court held that the failure to sign and swear to an otherwise regular return made it so defective that the Statute of Limitations would not commence to run despite the fact that subsequent to the filing thereof and at the request of the Collector a statement intended to supplement and cure the defect was signed, sworn to and filed.

Of similar import is the case of *Commissioner v. Lane-Wells Co.,* 321 US 219, 64 S. Ct. 511 (1944). That case held that the Statute of Limitations did not start to run where the taxpayer failed to file a separate personal holding company return which was re-

quired by Regulations of the Commissioner. In this connection the Court said:

> "The purpose is not alone to get tax information in some form but also to get it with such uniformity, completeness, and arrangement that the physical task of handling and verifying returns may be readily accomplished."

The implication by the Trial Court that the only thing Appellant failed to do was to attach a "Form 991" does not in and of itself avoid the problem because even formal defects may be fatal. The Regulations are clear, however, that it is the information to be contained in the form and not just the form itself which the Commissioner requires as a foundation for entitlement to deferment. This is not a case of failing only in submitting the information in (or on) the proper form, but is a case of failing to submit *at all* the information required to support the deferment.

It should be borne in mind that the normal course of processing claims for relief under Section 722 required the payment of the tax in full and the end result of successful prosecution was a *refund* of tax paid. A deferment contemplated by Section 710(a) (5) and the Regulations was allowable only in the *exceptional* case. Before allowing such deferment the Commissioner was charged with the responsibility of determining that the taxpayer *qualified* for the exceptional treatment. This determination was made at the time of the filing of the return. Subsequent consideration of applications for relief could have no bearing

whatsoever upon whether the determination respecting the deferment was rightly or wrongly made at the time of the filing of the return. (Note misunderstanding of this concept contained in conclusion of law, paragraph V, R. 55. Consideration of the application for relief "in the regular fashion" had nothing to do with the determination of whether a deferment should be allowed nor with the amount of the deferment to be allowed.) There is no evidence in this proceeding indicating that the Commissioner did anything in this respect upon the filing of the return. It is not known whether the Commissioner decided at that time that the taxpayer was entitled to deferment, but it is clear that such decision, if made, was erroneous under the terms of the section and the Regulations. It is also clear that at all times subsequent to the filing of the return until June 30, 1949 (over five years) the Commissioner had the complete and unlimited power to assess and collect the $70,130.71 which the taxpayer failed to pay upon the filing of its return, and there is no evidence in the record indicating that the taxpayer did anything to prevent or forestall the assessment and collection of this amount.

D. Conclusion.

"The amount of tax shown on the return" is governed by the general Statute of Limitations set forth in Section 275(a) of the Internal Revenue Code of 1939. Such amounts may be assessed and collected by the Collector of Internal Revenue at any time without sending any notice of deficiency, and without any other restrictions whatsoever. Obviously the Commis-

sioner was in much better position to enforce his rights here than in cases where the taxpayer's error does not appear on the face of the return. If assessment and collection are barred in a case where the error does not appear on the face of the return, they should certainly be barred in this case. Appellant's action in this respect could mislead no one, least of all the Commissioner, who, under the authority of Section 710(a)(5) had the power and discretion to legislate precisely what should be done in factual situations of this kind. This the Commissioner did, directing his Collectors to assess and collect the entire liability disclosed by the return.

II.

THE FINDINGS OF FACT AND CONCLUSIONS OF LAW DISCUSS "WAIVER," "BENEFIT TO TAXPAYER," "TAXPAYER'S OMISSION" AND SIMILAR ITEMS BUT NEITHER FACTUALLY NOR LEGALLY, NEITHER SEPARATELY NOR TOGETHER, DO THESE REFERENCES SUPPORT THE JUDGMENT.

A. The nature of the Statute of Limitations problem.

The basic concept of all Statutes of Limitations presupposes that the person relying upon the Statute will, by virtue of it, be unjustly benefited. It is presupposed that the taxpayer has made an error in his own favor. The justification for this is based upon the proposition that the party against whom the Statute of Limitations raises its bar has been given an adequate period of time within which to discover

the error and take such action as may have been necessary for that party's protection.

It might appear from the language of the findings of fact and conclusions of law that this case involved a unique situation, and one in which the bar of the Statute of Limitations operated unfairly and inequitably against the Defendant and Appellee. To test this concept, consider the usual tax case in which the general Statute of Limitations arises as a bar to the assessment and collection of income taxes. In the usual case the taxpayer, *ex hypothesi* will have understated the amount of tax legally due from him. He will have understated it either by omitting an item of gross income, or by claiming an unjustified deduction, credit or other allowance. In the great majority of the cases the error will not appear upon the face of the return. The return will be regular in all respects so far as appearances are concerned. There will be no opportunity for the Collector to look at the return, look at the Regulations (which bind him) and determine immediately upon the filing of the return that an error has been made. In the great majority of cases an actual field investigation is required to determine the facts as to the taxpayer's true tax liability. How much more difficult it is in the *usual case* for the Commissioner to determine that an error has been made and to take action in protection of his rights! Yet, the Statute of Limitations which applies in such cases is precisely the Statute of Limitations which Appellant contends should apply in this case.

B. Conceptual references in the findings of fact and conclusions of law do not support any recognized legal defense.

Only a brief discussion is required to demonstrate the fallacies contained in the conceptual references in the findings of fact and conclusions of law. Set forth below opposite the language of the findings of fact and conclusions of law these fallacies will be demonstrated.

Findings of Fact and Conclusions of Law.	**Fallacy.**
1. "The Commissioner took notice of the fact that taxpayer failed *strictly* to follow his Regulations but by his actions he clearly waived the regulatory requirement of filing a Form 991 with the return and allowed the taxpayer a deferment for 1943." (Emphasis supplied.) (Findings XIV, R. 52 and 53.)	1. This could be rephrased as follows: "The Commissioner knew that the taxpayer made a mistake, knew that he should assess the tax but decided not to." Note, however, the use of the word "strictly." Apparently the Court was reluctant to conclude that the Regulations could be *totally* disregarded. The record, however, shows they *had been* totally disregarded.
2. "Such deferment obviously benefited the taxpayer and having accepted the benefit it cannot be allowed to prevail here on the basis of a clear omission on its part." (Findings XIV, R. 53.)	2. The omission and the benefit were no more and no different than any taxpayer would have made or received in the usual Statute of Limitations situation, to-wit: there will always be an error or omission and there will always be the benefit of failure to collect. The omission appeared on the face of the return and the benefit resulted only from the failure to collect.
3. "The reference to the 1942 claim together with the	3. The record is devoid of any evidence showing that the

Findings of Fact and Conclusions of Law.

taxpayer's own course of conduct served to mislead the Commissioner to the extent that the taxpayer should not be allowed to take advantage of any error on the Commissioner's part." (Findings XVII, R. 53 and 54.)

Fallacy.

taxpayer either intentionally or inadvertently mislead the Commissioner in any respect. All *facts* were at all times in possession of the Commissioner. In no way did the taxpayer induce the Commissioner to wrongfully disregard his own Regulations. Paragraph VII(B) of the Stipulation (R. 28 and 29) shows that far from relying on Plaintiff the Commissioner made his own computations. If what happened here is sufficient to avoid the Statute of Limitations how easy it will be for the Commissioner to bring all of the usual Statute of Limitations cases within the doctrine adopted by the Trial Court! The same may be said of the statement that the taxpayer should not be allowed to take advantage of any error on the Commissioner's part. In essence, this finding and the previous one are self-contradictory, saying on the one hand the Commissioner knew what he was doing and on the other that the taxpayer mislead him.

4. "A suit for refund is based on equitable principles and it is in the nature of a suit for money had and received. The Plaintiff cannot be permitted to found its claim upon his own inequity or to take ad-

4. Whenever the Statute of Limitations applies in taxpayer's favor, it will be as a consequence of a taxpayer's error or "wrong." The record is devoid of any error on the taxpayer's part, save the origi-

Findings of Fact and Conclusions of Law.	Fallacy.
vantage of its own wrong." (Conclusions of Law IV, R. 55.)	nal error made in the filing of the taxpayer's 1943 return. It is not the taxpayer's wrong that is being taken advantage of, it is the Commissioner's failure to act in accordance with his own Regulations. The reference to a suit for refund, being based on equitable principles is inappropriate. Applied in the way it was applied by the Trial Court, it is obvious the concept would defeat every claim for refund based upon the Statute of Limitations and would fly in the face of the Congressional mandate contained in Section 3770(a)(2) of the Internal Revenue Code. Equitable defenses may be interposed in suits for refunds, but they must be recognized and established equitable defenses (*Ross v. Commissioner*, 169 F. (2d) 483 (1st Circuit, 1948)).

The whole tenor of the findings of fact and conclusions of law suggests the reliance upon an affirmative defense in the nature of an estoppel rather than a fundamental weakness in the contentions of the Appellant. Under F.R.C.P. 8(c) affirmative defenses such as "estoppel" and "waiver" must be affirmatively pleaded. They must be affirmatively pleaded for the two reasons which are dramatically applicable to this case:

1. The Defendant must plead and prove *each* element of a recognized defense;
2. The Plaintiff must be given the opportunity to present evidence or other matter contradicting or avoiding the effect of the purported defense.

There is no suggestion in the answer of the Defendant that it intended to rely upon an affirmative defense. Furthermore, the portion of the Stipulation on which the Defendant relies states expressly that such facts are admissible only to show:

"1. Whether or not the Commissioner of Internal Revenue knew of the fact that the taxpayer failed to follow his Regulations relating to applications for deferment under Section 710(a)(5) of the 1939 Revenue Code;

2. Whether or not the Commissioner by his actions intended to waive the Regulations to the extent that the taxpayer failed to follow said Regulations."

There is no suggestion in this Stipulation that the Defendant is relying upon any *conduct of the Plaintiff* as establishing a defense to this action. If paragraph VII is given the limited effect provided for in the Stipulation, the Defendant's failure to establish any recognized defense is even more apparent. It should be noted further that everything described in paragraph VII of the Stipulation happened OVER FOUR YEARS after the Plaintiff filed the 1943 return here

in issue, and much of it happened AFTER June 30, 1949, the date on which the general Statute of Limitations expired.

A skeleton summary in timetable form of the facts upon which the Defendant relies is as follows:

May 25, 1948—Defendant mailed to Plaintiff a thirty-day letter covering 1942, 1943, and 1944 (R. 27).

January 14, 1949—Defendant mailed to Plaintiff a Revenue Agent's report for 1945 and 1946 (R. 28).

December 9, 1948—Defendant made a memorandum which was never communicated to Plaintiff (R. 29).

June 30, 1949—The general Statute of Limitations expired.

December 1, 1949—Defendant mailed a thirty-day letter on the Section 722 relief issues (R. 29 and 30).

December 12, 1949—The Plaintiff executed a qualified agreement to the amount of constructive average base period net income (R. 30).

December 20, 1949—Another uncommunicated memorandum was made by Defendant (R. 30 and 31).

April 6, 1950—A "fifteen-day letter" re excess profits tax liability was sent (R. 31).

April 6, 1950—Also included in the fifteen-day letter was a statement that the claim for refund here in issue was recommended for disallowance in full (R. 33).

May 11, 1950—Statutory notice covering 1941, 1942, 1943 and 1945 re excess profits tax was mailed to Defendant (R. 32).

September 27, 1950—A letter between the Internal Revenue Agent in charge at San Francisco and the Deputy Commissioner of Internal Revenue which was never communicated to Plaintiff was written (R. 32 and 33).

The first three items consisting of two Revenue Agent's reports and one uncommunicated memorandum establishing no affirmative conduct of the Plaintiff whatsoever are wholly inadequate to establish any recognized legal defense. If the general Statute of Limitations contained in Section 275(a) of the Internal Revenue Code (26 USC 275(a)) applied as Plaintiff contends, nothing that happened after June 30, 1949, could revive Plaintiff's liability because not even an express agreement to that effect would be valid. Section 276(b) (26 USC 276(b)) which governs agreements extending the Statute of Limitations requires that they be executed "before the expiration of the time prescribed in Section 275 for the assessment of the tax". A good discussion of the proposition that what happens after the Statute of Limitations is run can have no effect, may be found in the case of *Elmer M. Melahn v. Commissioner,* 9 TC 769 (1947) commencing at page 775.

C. References to the 1942 situation.

Finally, the findings respecting what happened relative to the 1942 liability do not remedy the defects

(see Findings IV at R. 48, XIII at R. 52, XVI at R. 53, XVII at R. 54 and Conclusion of Law IV at R. 55).

If the Defendant is relying upon 1942 as establishing an agreed course of conduct respecting the treatment of 1943, the record is insufficient to support this defense for the following reasons:

1. Nothing in the record establishes the date upon which the amount unpaid with respect to 1942 was assessed and collected, for all that the record shows the Commissioner may have discovered his error and assessed and collected this amount prior to the expiration of the general Statute of Limitations, or the Commissioner may have failed to ever collect it.

2. The Defense is in the nature of an estoppel by conduct and the necessary element of "representation", "reasonable reliance", and "detriment" have been neither pleaded nor proved. The case of *Ross v. Commissioner, supra,* stands as authority also for the proposition that what has been done in prior years binds neither the Commissioner nor the taxpayer and particularly is this so where the Commissioner has been given all of the *facts*.

The false suggestion that the reference to the 1942 claim (Finding IV R. 48) supplied all of the defects respecting the 1943 return is also unsupported in the record. Finding XI (R. 51) makes a similar suggestion by referring to "the $82,229.48 claimed in the application (Form 991) filed for 1942 *upon which was based the deferment of $63,768.68 of excess profits tax*

liability shown on the original return for 1943." (Italics supplied.)

The Stipulation clearly provides (paragraph III (C), R. 20) that this $82,229.48 if applied to 1943 could serve as a basis for the deferment of only $12,-793.45 because only 33% of the *reduction* in tax claimed may be deferred.

The Defendant should not be allowed to prevail on the contention that he relied upon the existence of the 1942 claim but was not bound by its contents. Clearly cognizant that the mathematics for 1942 as to the *amount of deferment* could not apply to 1943 (Stipulation paragraph III(B), R. 19) Defendant made no attempt to determine the mathematics which would apply if the claim were related to 1943. The case of *Ross v. Commissioner, supra,* also stands as authority and the following quotations from the opinion are appropriate here:

> "But in the Crane and Countway cases, knowledge of the facts not disclosed was not imputed to the government. They do not qualify the proposition that a party may not successfully claim reliance on a misrepresentation when he knew the truth, nor probably even when he ought to have known the truth." (p. 495).
>
> "The record before us contains several references to the likelihood that respondent knew, or should have known, the true facts surrounding the accrual of petitioner's salaries and the unrestricted availability of these salaries after April, 1932." (p. 495).
>
> "A mere failure to report income is not a representation that such income has in fact not been

> received. Inasmuch as the tax incidence of so many transactions is as doubtful as it is, from the mere failure to report income no more significant inference should be drawn than the taxpayer's own interpretation of the law. And it seems settled that estoppel cannot be predicated upon a mere statement of law or silence resulting from an error of law." (p. 496).

D. Conclusion.

The findings of fact are in many material respects unsupported by any evidence in the record. In other respects they are confusing and contradictory. Together with the conclusions of law they base the judgment upon matters outside the issues framed by the pleadings, unsupported by any evidence, and not properly before the Court.

III.

THE TRIAL COURT ERRED IN DECIDING THE CASE BEFORE IT WAS SUBMITTED TO THE COURT AND PRIOR TO CONSIDERING AND ACTING UPON PLAINTIFF'S TIMELY AND VALID OBJECTION TO THE ADMISSION OF CERTAIN EVIDENCE.

While attorneys for Appellant were working on the Reply Brief to be submitted to the Trial Court pursuant to the Stipulation of Counsel, they received in the mail a letter from the Clerk of the Trial Court dated March 23, 1956, advising that:

> "The Court finds assessment and collection of taxes was within the period of limitations, therefore, the Plaintiff take nothing and the Defendant have judgment dismissing the Complaint and for its cost."

> When a party has mistakenly designated a defense as a counterclaim or a counterclaim as a defense, the court on terms, if justice so requires, shall treat the pleading as if there had been a proper designation." (Italics added)

Nothing could be clearer than that a Defendant wishing to rely upon any theory of "waiver" is required to set such defense forth in his answer. There is not the slightest suggestion in the answer of the Defendant that it intended to rely upon any defense of waiver (R. 11 et seq.).

Absent the contents of paragraph VII the record contains not even a suggestion of a defense. The objection was good, it was made in timely fashion and the Appellant was prejudiced by the failure of the Trial Court to sustain the objection.

IV.

THE APPELLATE COURT IS NOT BOUND IN ANY WAY BY THE FINDINGS OF THE TRIAL COURT.

Appellant wishes to briefly remind the Court that this case, being submitted by stipulation, is one where the Trial Court's findings have none of the usual intendments in favor of them. They are entitled to slight, if any, weight, and this Court is free to consider the stipulation and reach its own conclusions untrammeled by the District Court's findings and conclusions of law. *Equitable Life Assurance Society of the U. S. v. Irelan,* 123 F. (2d) 462 (CCA 9 1942);

Wigginton v. Order of United Commercial Travelers of America, 126 F. (2d) 659 (CCA 7 1942).

CONCLUSION.

Appellant respectfully submits that the Trial Court clearly committed error and that the granting of this appeal reversing the judgment of the Trial Court and ordering the refund as prayed for together with interest as provided by law is the only meet and proper decision in the premises.

Dated, Fresno, California,
February 12, 1957.

Respectfully submitted,
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Of Counsel.

(Appendix Follows.)

Appendix.

Appendix

STATUTES INVOLVED.

Internal Revenue Code:

Section 23 (26 USC Sec. 23):

Deductions from gross income.

"In computing net income there shall be allowed as deductions: . . ."

(m) Depletion.

"In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. . . ."

Section 271(a) (26 USC Sec. 271(a)):

Definition of deficiency—(a) In general.

"As used in this chapter in respect of a tax imposed by this chapter, 'deficiency' means the amount by which the tax imposed by this chapter exceeds the excess of—

(1) the sum of (A) the amount shown as the tax by the taxpayer upon his return, if a return was made by the taxpayer and an amount was shown as the tax by the taxpayer thereon, plus (B) the amounts previously assessed (or collected without assessment) as a deficiency, over—

(2) the amount of rebates, as defined in subsection (b) (2), made."

Section 275(a) (26 USC Sec. 275(a)):

Period of limitation upon assessment and collection—(a) General Rule.

Except as provided in section 276—

"The amount of income taxes imposed by this chapter shall be assessed within three years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period."

Section 276(b) (26 USC Sec. 276(b)):

Same—Exceptions . . . (b) Waiver.

"Where before the expiration of the time prescribed in section 275 for the assessment of the tax, both the Commissioner and the taxpayer have consented in writing to its assessment after such time, the tax may be assessed at any time prior to the expiration of the period agreed upon. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon."

Section 710(a)(5) (26 USC Sec. 710(a)(5)):

Deferment of payment in case of abnormality.

"If the adjusted excess profits net income (computed without reference to section 722) for the taxable year of a taxpayer which claims on its return, in accordance with regulations prescribed by the Commissioner with the approval of the Secretary, the benefits of section 722, is in excess of 50 per centum of its normal tax net income for such year, computed without the credit provided in section 26(e) (relating to adjusted excess profits net income), the amount of tax pay-

able at the time prescribed for payment may be reduced by an amount equal to 33 per centum of the amount of the reduction in the tax so claimed. For the purposes of section 271, if the tax payable is the tax so reduced, the tax so reduced shall be considered the amount shown on the return. Notwithstanding any other provision of law or rule of law, to the extent that any amount of tax remaining unpaid pursuant to this paragraph is in excess of the reduction in tax finally determined under section 722, such excess may be assessed at any time before the expiration of one year after such final determination."

Section 3770(a)(2) (26 USC Sec. 3770(a)(2)):

Authority to make abatements, credits, and refunds—To taxpayers . . . Assessments and collections after limitation period.

"Any tax (or any interest, penalty, additional amount, or addition to such tax) assessed or paid after the expiration of the period of limitation properly applicable thereto shall be considered an overpayment and shall be credited or refunded to the taxpayer if claim therefor is filed within the period of limitation for filing such claim."

Section 3771 (26 USC Sec. 3771):

Interest on overpayments—(a) Rate.

"Interest shall be allowed and paid upon any overpayment in respect of any internal revenue tax at the rate of 6 per centum per annum. . . .

"In the case of a refund, from the date of the overpayment to a date preceding the date of the refund check by not more than thirty days, such date to be determined by the Commissioner,

A taxpayer which claims to be entitled to a tax deferment under the provisions of section 710(a)(5) and of this section must, at the time of filing its excess profits tax return on Form 1121, attach thereto an application for relief under section 722 on Form 991 (revised January, 1943). The application must set forth under oath each ground under section 722 upon which the application for relief is based and facts sufficient to apprise the Commissioner of the exact basis thereof and to establish eligibility for relief, as well as data and information in sufficient detail to establish the amount of constructive average base period net income claimed, the amount of tax reduction claimed by the use of section 722, and the amount of tax deferment claimed on the return. In any case in which an application for relief on Form 991 (revised January, 1943) is not so attached to the excess profits tax return, the taxpayer shall not be deemed to have claimed on its return the benefits of section 722. In such case the amount of tax deferment claimed under section 710(a)(5) and this section shall be added to the amount of tax otherwise shown by the taxpayer to be payable. For the purposes of section 271 (made applicable to Subchapter E of Chapter 2 by section 729) relating to the definition of deficiency, the amount of tax shown by the taxpayer to be payable so increased shall be considered the amount of tax shown on the return.

For the purposes of section 271, in case a taxpayer has claimed a tax reduction under section 710(a)(5) and has attached Form 991 (revised January, 1943)

to its excess profits tax return as provided in this section, the tax so reduced shall be the tax shown on the return.

If a constructive average base period net income has been finally determined and has been used in computation of the excess profits tax for a prior excess profits tax taxable year under section 722 and under regulations prescribed under such section, such constructive average base period net income may be applicable in the computation of the excess profits tax for the current excess profits tax taxable year. In such case, the excess profits tax for such current year shall be computed with the use of such constructive average base period net income, and the provisions of section 710(a)(5) shall be inapplicable with respect to such year.

The application of section 710(a)(5) may be illustrated by the following example:

Assume that corporation B, which makes its return on the calendar year basis, has for 1942 a net income of $1,010,000, which includes $300,000 of dividends on the common stock of domestic manufacturing corporations, $10,000 of interest on certain United States Government obligations which is exempt from the normal tax, and $20,000 of long-term capital losses which are offset against an equal amount of short-term capital gains. Its adjusted net income is $1,000,000, and it has an excess profits credit of $95,000, and no unused excess profits credit adjustment. It has filed, with its excess profits tax return for 1942,

an application for relief under section 722 in which it claims a constructive average base period net income of $600,000. Its excess profits tax return for 1942, computed without regard to section 722, shows an amount of tax deferred under section 710(a)(5) of $99,584.10, and an excess profits tax due of $494,685.90, computed as follows:

Excess Profits Tax

1.	Normal tax net income (computed without allowance of credit under section 26(e) for income subject to excess profits tax and without allowance of dividends received credit) (item 22)		$1,000,000.00
2.	Plus long-term capital loss adjustment		200,000.00
3.	Item 1 plus item 2		$1,200,000.00
4.	Less dividend received credit adjustment (100 percent of item 25)		300,000.00
5.	Excess profits net income		$ 900,000.00
6.	Less specific exemption	$ 5,000	
7.	Excess profit credit	95,000	
8.	Total of item 6 and item 7		100,000.00
9.	Adjusted excess profits net income (item 5 minus item 8)		$ 800,000.00
10.	Excess profits tax (90 percent of item 9)		720,000.00
11.	Net income (computed without regard to credit provided in section 26(e) relating to income subject to excess profits tax) (item 21)		$1,010,000.00
12.	Dividends received	$300,000	
13.	Less dividends received credit (85 percent of item 12, but not in excess of 85 percent of item 11)		255,000.00

14.	Corporation surtax net income (computed without regard to the credit provided in section 26(e)) (item 11 minus item 13)		$ 755,000.00
15.	80 percent of item 14		$ 604,000.00
16.	Income tax under chapter 1 (other than section 102) for the taxable year (item 36)		9,730.00
17.	Excess of item 15 over item 16		$ 594,270.00
18.	Excess profits tax (item 10 or item 17, whichever is lesser)		$ 594,270.00
19.	Less tax deferred under section 710(a)(5) (item 56)		99,584.10
20.	Excess profits tax payable (item 18 minus item 19)		$ 494,685.90

Normal Tax

21.	Net income		$1,010,000.00
22.	Adjusted net income (item 21 minus $10,000 interest on certain U. S. obligations)		$1,000,000.00
23.	Less income subject to excess profits tax (credit under section 26(e)) (item 9)		800,000.00
24.	Item 22 minus item 23		$ 200,000.00
25.	Dividends received	$300,000	
26.	Less dividends received credit (85 percent of item 25 but not in excess of 85 percent of item 24)		170,000.00
27.	Normal tax net income		$ 30,000.00
28.	Normal tax ($4,250 plus 31 percent of $5,000)		$ 5,800.00

Surtax

29.	Net income (item 21)		$1,010,000.00
30.	Less income subject to excess profits tax (credit under section 26(e)) (item 9)		800,000.00

31. Item 29 minus item 30		$ 210,000.00
32. Dividends received	$300,000	
33. Less dividends received credit (85 percent of item 32 but not in excess of 85 percent of item 31)		178,500.00
34. Corporation surtax net income		$ 31,500.00
35. Surtax ($2,500 plus 22 percent of $6,500)		$ 3,930.00
36. Total normal tax and surtax (item 28 plus item 35)		$ 9,730.00

Percentage which adjusted excess profits net income bears to normal tax net income computed without credit under section 26(e) for income subject to excess profits tax.

37. Adjusted excess profits net income computed without regard to section 722 (item 9)		$ 800,000.00
38. Adjusted net income (item 22)		$1,000,000.00
39. Dividends received	$300,000	
40. Dividends received credit (85 percent of item 39 but not in excess of 85 percent of item 38)		255,000.00
41. Normal tax net income (computed without regard to the credit for income subject to excess profits tax under section 26(e))		$ 745,000.00
42. Percentage which item 37 bears to item 41 ... percent		107

Tax deferred under Section 710(a)(5)
Excess profits tax under Section 722

43. Excess profits net income (item 5)		$ 900,000.00
44. Less specific exemption	$ 5,000	
45. Excess profits credit based on constructive excess profits net income under section 722 (95 percent of $600,000)	570,000	
46. Item 44 plus item 45		575,000.00

47.	Adjusted excess profits net income computed under section 722 (item 43 minus item 46)....	$ 325,000.00
48.	Excess profits tax under section 722 (90 percent of item 47)	$ 292,500.00
49.	Corporation surtax net income (computed without regard to the credit provided in section 26(e)) (item 14)	$ 755,000.00
50.	80 percent of item 49	$ 604,000.00
51.	Income tax under Chapter 1 (other than section 102) for the taxable year, computed with the excess profits tax determined under section 722 (item 72)	169,600.00
52.	Excess of item 50 over item 51	$ 434,400.00
53.	Excess profits tax computed without the benefit of section 722 (item 17)	$ 594,270.00
54.	Excess profits tax computed under section 722 (item 48 or item 52, whichever is lesser)......	292,500.00
55.	Amount of tax reduction claimed under section 722 (item 53 minus item 54)	$ 301,770.00
56.	Amount of tax deferred under section 710(a) (5) (33 percent of item 55)	$ 99,584.10

Normal Tax

57.	Net income (item 21)	$1,010,000.00
58.	Adjusted net income (item 22)	$1,000,000.00
59.	Less income subject under section 722 to excess profits tax (credit under section 26(e)) (item 47)	325,000.00
60.	Item 58 minus item 59.....................	$ 675,000.00
61.	Dividends received $300,000	
62.	Less dividends received credit (85 percent of item 61 but not in excess of 85 percent of item 60)	255,000.00

63. Normal tax net income		$ 420,000.00
64. Normal tax (24 percent of item 63)..........		$ 100,800.00

Surtax

65. Net income (item 21)		$1,010,000.00
66. Less income subject under section 722 to excess profits tax (credit under section 26(e)) (item 47)		325,000.00
67. Item 65 minus item 66		$ 685,000.00
68. Dividends received	$300,000	
69. Less dividends received credit (85 percent of item 68 but not in excess of 85 percent of item 67)		255,000.00
70. Corporation surtax net income (item 67 minus item 69)		$ 430,000.00
71. Surtax (16 percent of item 70)		68,800.00
72. Total normal tax and surtax (item 64 plus item 71)		169,600.00

(The following paragraph was added by amendment, T.D. 5679, 1949-1CB132, December 16, 1948 as the result of the enactment of the limitation provision in 1948. It did not appear in the text in effect the date the Plaintiff's 1943 Excess Profits Tax return was filed.)

If the taxpayer defers under section 710(a)(5) payment of an amount in excess of the reduction in tax finally determined under section 722, such excess may be assessed at any time before the expiration of one year after such final determination. Such assessment may be made regardless of whether the assessment of a deficiency for such taxable year is otherwise barred by the running of any period of limitations, by the decision of any court, including The Tax Court,

or by any other provision (such as section 272(f)) or rule of law. The reduction in tax under section 722 is finally determined, in cases in which the Commissioner's action is subject to review by The Tax Court under section 732, upon the expiration of the period for review with The Tax Court or, if such petition is filed, upon the Commissioner's sending notice by registered mail to the taxpayer of his final action on the application for relief under section 722. If the Commissioner should, at the request of the taxpayer, agree because of unusual circumstances to reconsider his action on an application, the immediately preceding sentence shall be applied with respect to the Commissioner's second determination.